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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 1037

I. HASBROUCK CHAHOON, PETITIONER

v.

HARRY M. HICKEY, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE FOURTEENTH DISTRICT OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 2–7) are reported in 60 F. Supp. 409. The opinion of the Circuit Court of Appeals (R. 8–10) has not yet been reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 2, 1946. (R. 10.) The petition for a writ of certiorari was filed on April 1, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial

Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner was president and a stockholder of a bank; he was also a stockholder in several corporations that had deposits in that bank. The bank was solvent. In computing his net income may he deduct, as a business expense or as a loss, an amount paid under an agreement to idemnify the bank against loss from depreciation in the value of its securities?

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.
>
> * * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

STATEMENT

The facts were stipulated by the parties and found by the District Court (R. 2–7) as follows:

The taxpayer, in 1931, was the president of Plattsburg National Bank & Trust Company, Plattsburg, New York, and was the owner of 148 of the 5,000 issued shares of the bank's capital stock. (R. 3, 5.) His salary was $10,000 per annum until January 1, 1934, when it was reduced to $5,500. (R. 3.) He also received substantial salaries from several corporations in which he and his family were stockholders, and those corporations had some $256,000 on deposit with the bank. (R. 3–4, 6.)

In July, 1931, the bond portfolio of the bank showed a shrinkage in value of $440,000. Although that shrinkage and other losses resulted in an impairment of capital, the bank was solvent and had a net capital of some $353,000 after deducting all estimated losses. (R. 5, 9.) The bank examiners recommended that something be done to improve the bank's position and, to meet

this suggestion, the taxpayer and other stockholders and directors of the bank entered into an agreement whereby they gave their personal notes aggregating $400,000 to underwrite any loss to the bank arising out of the shrinkage in value of bonds held by the bank. The amount of the notes was the amount of the difference between the cost of the bonds and their then market value. (R. 6.)

Under the agreement, the taxpayer and the other subscribers were bound to make up the difference between the ultimate selling price and the cost of the bonds to the extent of $400,000. The agreement provided that if the sale of the bonds resulted in a profit, the profit was the bank's. The taxpayer gave his note for $100,000. (R. 6.)

In 1936, the taxpayer and the other subscribers were required to make good the difference between the cost and the market value of the bonds. The taxpayer's share of the difference was determined to be $48,000 which he paid in cash in that year. (R. 6.)

In his income tax return for that year, the taxpayer took this amount as a deduction. (R. 6.) The Commissioner disallowed the deduction and, as a result, assessed a deficiency in income taxes in the sum of $11,311.45 which was paid on February 8, 1939. (R. 2–3.)

On February 6, 1941, the taxpayer filed a claim for the refund of the amount thus paid which the Commissioner rejected by registered letter dated March 2, 1942. This suit was commenced on February 29, 1944. (R. 3.)

Upon these findings, the District Court concluded that the taxpayer was entitled to the deduction claimed, either as a necessary business expense or as a business loss, and granted judgment as demanded in the complaint. (R. 7.)

The Circuit Court of Appeals held that the deduction was not allowable either as a loss or a business expense and reversed the judgment of the District Court. (R. 8–10.)

ARGUMENT

Taxpayer erroneously asserts that the Circuit Court of Appeals reversed the findings of the District Court and drew different inferences of its own without an opportunity to examine the evidence. On the contrary the decision of the Circuit Court of Appeals was based upon the view that the findings of the District Court did not support its judgment.

The findings disclosed that the taxpayer agreed to indemnify a bank against losses on the sale of certain bonds which had depreciated in value; that he made himself liable to the extent of $100,000; that various corporations in which he was interested and from which he drew salaries

had large deposits in the bank (R. 6); that the bank had sufficient assets to pay its depositors in full (R. 5); and that in 1931 the taxpayer received a salary of $10,000 from the bank, which was reduced in 1934 to $5,500 (R. 3). The District Court further found that the taxpayer's participation in the agreement was a normal business transaction made in order to protect his extensive interests and substantial salaries in the various corporations, particularly the bank. (R. 7.)

It is settled that expenses incurred by an individual to protect the business of a corporation in which he is interested are not ordinary and necessary expenses of the individual. *Burnet* v. *Clark,* 287 U. S. 410; *Deputy* v. *du Pont,* 308 U. S. 488. Similarly it has been held that such expenses are not deductible as losses. *In re Park's Estate,* 58 F. 2d 965 (C. C. A. 2d), certiorari denied, 287 U. S. 645. The District Court found that the expenses here involved could be disassociated from the bank by reason of the taxpayer's interests in depositors of the bank who might suffer from the latter's failure. But the Circuit Court of Appeals properly pointed out that the bank had sufficient assets to pay its depositors in full and that hence the potential liability of $100,000 assumed by the taxpayer had no reasonable business relationship to the losses he would have suffered if the bank had been closed.

Thus the Circuit Court of Appeals reversed the decision of the District Court for its failure to apply the rule of law announced in the cases cited above. Moreover, it would have been appropriate for the court to go further and hold that the rule of the above cited cases could not be avoided even if the taxpayer's assumption of liability had been necessary to protect the depositors.

Since we think that a Tax Court decision would have been reviewable under similar circumstances, there is no occasion here to consider whether the rule of *Dobson* v. *Commissioner,* 320 U. S. 489, has any application in an appeal from a District Court.

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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APRIL 1946.

U. S. GOVERNMENT PRINTING OFFICE: 1946